

# ARKANSAS DEVELOPMENT FINANCE AUTHORITY

## COMPLIANCE MONITORING POLICIES AND PROCEDURES MANUAL FOR THE LOW INCOME HOUSING TAX CREDIT PROGRAM

Adopted by the Board of Directors ~~July 17, 2008~~ August 20, 2009  
Effective ~~September 5, 2008~~ October 12, 2009  
(All other versions are obsolete)

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## **SECTION I – GENERAL INFORMATION**

### **I.A INTRODUCTION**

The Arkansas Development Finance Authority (“ADFA” or the “Authority”), a public body politic and corporate, with corporate succession, was created May 1, 1985 by Act 1062. This act abolished the former Arkansas Housing Development Agency that had existed since 1977. The former agency had as its sole purpose to sell tax-exempt bonds and use the proceeds to develop safe, decent, sanitary and affordable housing for low and moderate income Arkansans. All records, funds, properties, obligations, debts, functions, powers and duties were transferred to ADFA, which sells both taxable and non-taxable bonds and supports programs not only for housing but also for economic development, agriculture, aquaculture, export finance, government finance, and tourism development.

This Policies and Procedures Manual presents an overview of ADFA’s policies as they pertain to compliance monitoring for the Low Income Housing Tax Credit (“LIHTC”) Program. The procedures are designed to assist owners and managers of developments that have received an allocation pursuant to the LIHTC Program to ensure that the developments remain in compliance with Section 42 of the Internal Revenue Code (“the Code”). The procedures are not intended to be all-inclusive. In the event of a conflict or inaccuracy, the Code will control. If the development has received a combination of funds from other government entities, owners generally follow the most restrictive regulations. Owners must be aware, however, that he may have to satisfy the requirements of all applicable regulations. For instance, an owner may have received funds under a governmental program in which he agreed to rent a certain number of units to persons earning 40% or less of the area median income. The owner must be sure to satisfy this restriction in addition to the applicable LIHTC area median income limit. Employees and officers of ADFA are not liable for any adverse consequences that affect the taxpayer or investor relative to compliance with the federal tax code. ADFA reserves the right to implement additional policies as needed. Also, new rulings or other changes may be made periodically. Owners are responsible for compliance with any amendments or updates to the federal regulations.

Any questions regarding this Manual should be directed to:

Compliance Monitoring Department  
Arkansas Development Finance Authority  
P. O. Box 8023  
Little Rock, AR 72203-8023  
Telephone: (501) 682-5900  
Telecopy: (501) 682-5859

## **I.B BACKGROUND**

Congress created the LIHTC Program under the Tax Reform Act of 1986. The LIHTC Program, governed by Section 42 of the Internal Revenue Code, began in 1987. The tax credit is a dollar-for-dollar reduction in tax liability to investors in exchange for equity participation in the construction or acquisition and rehabilitation of rental housing that will remain income and rent restricted for an extended period of time. Tax credits are allocated by ADFA for properties located in Arkansas. After ADFA allocates the tax credits to developers, the developers typically sell the credits to private investors. The private investors use the tax credits to offset taxes otherwise owed on their tax returns. The money private investors pay for the credits is paid into the projects as equity financing. Equity financing is used to fill the gap between development costs for a project and the non-tax credit financing sources, such as mortgages, that could be expected to be repaid from rental income. In awarding the credits, ADFA attempts to provide sufficient credits to ensure the project's financial feasibility throughout the 15-year tax credit compliance period. ADFA must consider any proceeds or receipts expected to be generated through tax benefits, the percentage of housing credit dollar amounts used for project costs other than the cost of intermediaries, and the reasonableness of developmental and operational costs. Generally, ADFA will compare the proposed project's developmental costs with the nontax credit financing, both private and governmental. The difference between the development costs and the nontax credit financing is the financing gap. Tax credits are used to attract the equity investment needed to fill the gap, but are limited to a ceiling.

ADFA is also designated as Arkansas' LIHTC compliance monitoring agency. Crucial elements of compliance are ensuring that the appropriate number of tax credit units is occupied by eligible households, following income eligibility guidelines and restricting rents over a specified time period. ADFA also monitors to ensure LIHTC properties are decent, safe, sanitary, and in good repair. ADFA is available to provide guidance to owners in maintaining continuous compliance with federal and state LIHTC guidelines throughout the compliance period.

## **I.C CREDIT PERIOD AND COMPLIANCE PERIOD**

Generally, owners must place the projects in service within two (2) years of carryover allocation or return the credits to ADFA for reallocation to other projects. Once a development is placed in service, it is generally eligible for the tax credit every year for ten (10) years. To continue generating the credit and avoid recapture, an LIHTC building must satisfy specific tax credit compliance rules for fifteen (15) years. In cases where 100% low-income occupancy is not achieved during the first tax credit year, (for example, either due to unqualified tenants or inability to find qualified tenants to qualify units) there will be possible increases in qualified basis in subsequent years. In such cases, excess qualified basis shall have the percentage equal to 2/3 of the applicable fraction applied, thus extending the tax credits claimed over the 15-year compliance period. The tax credits may be generated annually on a building-by-building basis beginning either with the taxable year in which the

building is placed in service or, at the election of the taxpayer (owner), the succeeding taxable year.

For buildings placed in service in 1987, the credit was taken at annual rates of 9 percent (for the 70 percent value credit) and 4 percent (for the 30 percent value credit). Three types of credit are available for low-income buildings placed in service after 1987. The first type of credit is a 9 percent annual credit for the cost of a new building or qualifying rehabilitation costs, without a federal subsidy. The second type of credit is a 4 percent annual credit for the cost of a new building or substantial rehabilitation built with a federal subsidy. The third type of credit is a 4 percent annual credit for the cost of buying an existing building for which substantial rehabilitation expenditures are also incurred. Although the 9 percent and 4 percent credits are called 9 percent and 4 percent, the figures are actually estimates. The IRS sets the figures each month based upon fluctuating interest rates. A project can qualify for one of the three credits or a combination of the credits.

Low income housing tax credit amounts are based on the cost of a building and the portion of the project that low-income households occupy. The cost of acquiring, rehabilitating, and constructing a building constitutes the building's eligible basis. The portion of the eligible basis attributable to low-income units is the building's qualified basis. Generally, the qualified basis excludes the cost of land. Developers are urged to consult legal counsel, as other costs may be excluded.

Low-income housing tax credit projects that use federal subsidies generally receive a smaller credit. If federally subsidized loans are used to finance substantial rehabilitation or new construction, either the eligible basis of the building must be reduced or the 30% credit must be used. Federally subsidized loans include below-market federal loans and tax-exempt financing.

The compliance period for any building is the period beginning on the first day of the first taxable year of the credit period of such building and ending fifteen (15) years from such date. Beginning in 1990, ADFA implemented the Land Use Restriction Agreement ("LURA"), which extended the compliance period for an additional fifteen-year period. The LURA, recorded in the real estate records of the county in which the development is located, is a binding agreement of the owner and any successors to maintain specific occupancy and affordability requirements for the development.

Projects placed in service before the use of the LURA (1987, 1988, 1989,) must comply with the 15-year compliance period only. In reference to those projects, ADFA will review the IRS form 8609 to determine the year the owner claimed the tax credits. If there is no completed copy of the IRS form 8609 available, ADFA staff will ask the project owner to confirm the credit year. Upon determining that the 15-year compliance period has expired, ADFA will notify the owner that the compliance period has ended and that ADFA will no longer conduct physical or tenant file audits.

After the initial 15-year compliance period, ADFA will continue to monitor developments with extended use agreements. ADFA intends to enforce the terms and agreements set forth in the Land Use Restriction Agreement and Declaration of Restrictive Covenants for the Low Income Housing Tax Credits (“LURA”) and ADFA’s Compliance Monitoring Policies and Procedures Manual for the LIHTC Program. ADFA will not modify any of the Section 42 requirements. Owners will be allowed specific time periods, as deemed appropriate by ADFA, to correct items of noncompliance.

Remedies for noncompliance include, but are not limited to, the following:

- Temporary suspension or permanent expulsion from participation in the LIHTC, HOME, or any other program administered by ADFA;
- Notification to other lenders or agencies that provided funding for the project;
- Notification to the limited partners, syndicators, board of trustees, or any other affiliate of the project; and
- Legal action.

#### **I.D. FOUR TAX CREDIT REGULATION PERIODS**

Since the 1986 enactment of the LIHTC, Congress has changed or amended the laws governing the program, yet many changes have not been retroactive. In some cases, the change in regulations brought forth by a technical correction is minor; in others, the effect is substantial. Owners must be aware of the differences in regulations and which credit period applies to each building or development. The period considered for management/compliance purposes is the year in which tax credits were allocated by ADFA. Currently, there are four (4) specific credit regulation periods as follows:

1. January 1, 1987 – December 31, 1989

Properties receiving credit allocations during this period based rent on the number of people living in the unit. Rents were subject to change whenever the household composition changed. The Omnibus Reconciliation Act of 1993 allowed owners of these developments a one-time opportunity to either maintain the per-person formula or elect to change to the formula based on apartment bedroom size used for 1990 and later allocations. The owner had to write to the IRS no later than February 6, 1994, to request this election. Once made, the decision to switch formulas or retain the per-person formula was irrevocable. The new rent formula only affected any new move-ins on or after the election date. A copy of the election letter must be provided to ADFA or available during the on-site inspection.

2. 1990

Rent is calculated by number of bedrooms in a unit. This rule was not retroactive. Gross Rent Floor was adopted. This rule was not retroactive. See definition herein. Extended Low-income Housing Commitment required. See Section I.C for further Discussion.

3. 1991

AFDC Student Rule exception was retroactive. See Section III.P  
FmHA Overage Rule (not retroactive) is discussed in Section III.F.  
Extension on Initial Compliance with Set-Aside (not retroactive).  
Minimum Set-Aside requirements are discussed in Section III.A.

4. August 10, 1993

Married Students Rule (retroactive). We discuss students in Section III.Q.  
Single Parent Student Rule (not retroactive).  
1987-1989 Rent Change Option (special rule)  
Section 8 requirement (retroactive) that states owners cannot refuse to lease to  
Section 8 tenants.

References: Blue Book, Section 42 of the Code, Congressional Laws

**I.E. ADDITIONAL REVENUE RULINGS**

Two important revenue rulings were later issued that were not retroactive.

September 9, 1992	IRS Revenue Ruling 92-61 deals with treatment of staff units as part of the eligible basis.
September 26, 1997	Section 1.42-15 Available Unit Rule was adopted as an amendment to the regulations. This rule allows over-income persons in LIHTC units to relocate to another unit in the same building.

**I.F. RESPONSIBILITIES OF OWNERS**

Compliance with the requirements of the Code is the development owner's responsibility. ADFA's obligation to monitor the development for compliance does not make ADFA liable for an owner's non-compliance, nor does it alleviate an owner's duty to comply with applicable Code requirements. In Compliance with Section 42 of the Code and in accordance with ADFA's Compliance Monitoring Policies and Procedures Manual for the LIHTC Program, the owner, by accepting the allocation of low-income housing tax credits, is obligated to:

- (1) Manage the development in accordance with the Code, and all other applicable regulations and agreements;



- (2) Ensure that, once the development is placed in service, it is suitable for occupancy by meeting Uniform Physical Conditions Standards (“UPCS”) and/or ADFA-approved design standards.
- (3) Ensure that the development is continually managed in accordance with all applicable federal, state, local and fair housing laws;
- (4) Ensure that the complete records for the first year of the credit period are maintained for a minimum of twenty-one (21) years<sup>1</sup>;
- (5) Ensure that the records for subsequent years are maintained for a minimum of six (6) years after the due date for filing the federal income tax return for that year;
- (6) Immediately notify ADFA of the placed in service date, initial credit year, completion of the development, as well as any material changes such as ownership or management that is made at any time during all phases of development; see pages 40 -41 for ownership or management notification requirements;
- (7) Furnish to ADFA a signed copy of the completed IRS form 8609, and make available all such 8609 forms to ADFA’s staff during any on-site review;
- (8) Cooperate with ADFA’s staff during compliance reviews;
- (9) Furnish a copy of the election request to the IRS, showing change from family size to unit size in determining maximum allowable rents;
- (10) Furnish the annual Owner’s Certificate of Continuing Program Compliance no later than February 1<sup>st</sup> of the year following the first credit year and every year thereafter during the compliance period. ADFA will no longer provide copies of forms. The owner is responsible for downloading forms from the ADFA website- [www.arkansas.gov/adfa](http://www.arkansas.gov/adfa) . Tenant data must be submitted electronically via ADFA’s computer software. The Owner’s Certification, attached hereto as Exhibit B, is an annual requirement for the duration of the compliance period. Owners or managers should enter tenant data online as events occur but no later than February 1<sup>st</sup> each year;
- (11) Assume liability for any instance of non-compliance and to correct such deficiencies as required; and
- (12) Notify ADFA of any casualty loss of a unit or building within thirty (30) days of the loss.

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<sup>1</sup> Refer to the IRS Compliance Monitoring Requirements – Page A-72(b)(2) Record Retention Provision, a copy of which is attached hereto as Exhibit A.

## SECTION II – COMPLIANCE REQUIREMENTS

### II.A REVIEWS

Fundamental requirements include the following: (1) the project must be residential rental property; (2) the owner must establish and maintain a minimum set-aside of units that will be available to and occupied by low-income tenants; (3) tenant eligibility must be properly documented; (4) rents must be affordable to low-income tenants; (5) habitability standards must be maintained; and (6) the residential rental units must be available for use by the general public in a nondiscriminatory manner. Additional requirements may also apply.

After a qualified development has been placed in service, ADFA will initiate compliance monitoring reviews. ADFA's staff will audit each development within 180 days following the first taxable credit year and once every three years throughout the compliance period. ADFA's staff will conduct on-site inspections of all buildings in the project and will randomly select a minimum 20% of tax credit units and tenant files for review.

ADFA's staff will contact the owner or manager to schedule the on-site inspections, which will include the following reviews:

- A. Record Keeping
- B. Fair Housing
- C. Tenant Files
- D. Uniform Physical Conditions Standards ("UPCS") for Buildings, Units and Common Areas and ADFA design standards. See Section II.E.

### II.B RECORD KEEPING

ADFA recommends that each development owner or manager maintain an "**Administrative File/Binder for ADFA LIHTC Record Keeping Procedures.**" Since the information will be reviewed by ADFA during each visit, the Administrative File/Binder must include, but is not limited to the following items:

- Completed 8609 forms on each building with building identification numbers (signed by ADFA, Part II completed and signed by the development owner);
- Records that indicate the character and use of any nonresidential portion of the development included in eligible basis as defined under Section 42(d). For example, tenant facilities that are available on a comparable basis to all tenants for which no separate fee is charged for the use of the facilities or facilities reasonably required by the development;
- Certificates of Occupancy or Approval;

- The eligible basis and qualified basis of the building at the end of the first year of the credit period;
- Copy of Land Use Restriction Agreement (“LURA”) or other extended use agreement;
- The vacancy history of the low income units and when and to whom the next available unit was rented;
- Total number of units in the property (this information must be retained on a building-by-building basis including the number of bedrooms and the square footage of each unit);
- HUD income tables for all years the development has been placed in service;
- Household size;
- Rents charged on each type of unit, including applicable utility allowances for all years the development has been placed in service;
- Non-residential use fee (i.e. additional fees charged for parking, etc.);
- 20/50 Test, Section 42 of the Code, OR 40/60 Test, Section 42 of the Code (also known as the minimum set-aside);
- Partnership Agreement;
- Management Agreement;
- Evidence of Fair Housing Compliance;
- Copies of reports submitted to ADFA (such as occupancy status reports); and
- Change in Ownership documentation, if applicable
- Bank statements to confirm amounts in operating reserve account and replacement reserve accounts.

First year records (including the tenant file for each tenant that initially occupied the LIHTC units, rent rolls, etc.) provide evidence that the property met its minimum set-aside, targeted applicable fraction, and other elected set-asides. Such first year records must be kept for a minimum twenty-one (21) years and subsequent records must be kept for a minimum of six (6) years, as mandated under the Code. ADFA requires the owner to certify on the Owner’s Certificate of Continuing Program Compliance that he is complying with this section of the Code.

## **II.C FAIR HOUSING**

During the on-site visit, ADFA’s staff, in addition to interviewing tenants, will check the following:

- Posting of Equal Housing Opportunity symbol on all advertising and exterior property sign;
- Display of the Equal Housing Opportunity sign in office where tenant applications are taken;
- Existence of acceptable number and location of accessible units, parking spaces and their proximity to ramps, etc.;
- Maintenance of waiting lists and sign-in sheets;
- Diverse placement of accessible units for the disabled;
- Safe and sanitary condition of accessible units for the disabled;
- Utilization of a current Affirmative Fair Housing Marketing Plan (ADFA can provide necessary forms if owner needs assistance in developing and implementing a Plan);
- Documentation of affirmative fair housing marketing and outreach efforts; and
- Records used to collect racial data on the head of household. This information is for statistical purposes only.

Requirements for New Buildings: In buildings that were ready for first occupancy after March 13, 1991, and have an elevator and four (4) or more units:

- Public and common areas must be accessible to persons with disabilities;
- Doors and hallways must be wide enough for wheelchairs;
- The main entrance for the building must be at least 32 inches wide, measured between the face of the door and opposite doorjamb;
- All units must have (1) an accessible route into and through the unit; (2) accessible light switches, electrical outlets, thermostats and other environmental controls; (3) reinforced bathroom walls to allow later installation of grab bars; and (4) kitchens and bathrooms that can be used by people in wheelchairs;
- ADFA may request additional information for statistical purposes.

#### **II.D TENANT FILES**

ADFA requires files to be maintained in a consistent order. ADFA's staff will randomly select and review at least 20% of current tenant files, as required by IRS. First year tenant files must also be available on site for review. ADFA staff will conduct a thorough examination to:

- Ensure that all documents are completed, signed and dated by all appropriate parties;
- Review initial tenant income certifications;
- Review executed leases for the initial lease term of six (6) months or longer and for rents charged for each LIHTC unit;
- Review signed authorization for release of income, employment and asset information;
- Review and document annual income, subsidized rent, tenant contribution, utility allowance, and gross rent for compliance with LIHTC program limits;
- Ensure that third party income verifications are completed, signed and dated by all parties;
- Ensure that appropriate asset income verifications are used;
- Ensure that income recertifications are completed within the 12-month period;
- Review original tenant applications;
- Review student eligibility guidelines;
- Review unit inspection forms (unit inspections are recommended quarterly) and maintenance records; and
- Review tenant complaint forms, responses, and other correspondence.

ADFA recommends the use of files divided into sections as follows with the latest information on top:

#### Section I

- Original Signed Tenant Application
- Signed Leases
- Signed Tenant Agreement

#### Section II

- Move-in Tenant Income Certification (TIC) plus accompanying copies of birth certificates, Social Security cards, if applicable
- Affidavit of alimony or child support
- Authorization of release of information
- Real estate verification
- Worksheet and calculator tape supporting determination of resident eligibility
- Statement of student status, if applicable
- Third-party verifications of income

- Self-employment verification, if applicable
- Social Security payment letters
- Zero income statement, if applicable
- Bank statements
- Asset statements and verifications
- Telephone conversation reports clarifying third party verifications or other similar circumstances ,if applicable
- Annual signed Recertifications

#### Section III

- Rent and income limits for each year of compliance
- Copy of annual utility allowances for each year of compliance
- Current amount of rental assistance payments
- Current amount of rent paid by tenant
- Copies of tenant's checks or receipts, if applicable

#### Section IV

- Correspondence between tenant and manager

#### Section V

- Proof of move-in inspection signed by tenant and manager
- Proof of quarterly unit inspections and maintenance requests
- Proof of repairs needed or requested (repairs must be made within 30 days)
- Copies of work orders
- Copies of receipts or proof of completion
- Proof of move-out inspection

The above-mentioned documents under Section V may also be maintained in a separate "Unit Maintenance" folder.

### **II.E UNIFORM PHYSICAL CONDITIONS STANDARDS AND/OR ADFA-APPROVED DESIGN STANDARDS**

ADFA's staff will conduct inspections of the units that are randomly selected for file audit and will utilize Uniform Physical Conditions Standards and/ or ADFA-approved design standards. Owners may utilize standardized inspection forms for quarterly unit inspections. ADFA staff will inspect major areas of the property, identify the defect and the severity level of the defect. The levels are 1, 2, and 3 with 3 being the most severe. Any life threatening hazard must be addressed immediately. UPCS identifies the following inspectable areas: (1) the site; (2) building exterior; (3) building systems; (4) dwelling units; (5) common areas; and (6) health and safety considerations.

- (1) The site: Site components, such as fencing, gates, and retaining walls, grounds, lighting, mailboxes, project signs, parking lots/driveways/roads, play areas and equipment, refuse disposal, and storm drainage must be free of health and safety hazards and be in good repair. The site must not be subject to material adverse conditions, such as abandoned vehicles, dangerous walks or steps, poor drainage, septic tank back-ups, sewer hazards, excess accumulation of trash, vermin or rodent infestation or fire hazards.
- (2) The building exterior: Each building on the site must be structurally sound, secure, habitable, and in good repair. Each building's doors, fire escapes, foundations, lighting, roofs, walls, and windows where applicable, must be free of health and safety hazards, operable, and in good repair.
- (3) Building Systems: Each building's domestic water, electrical system, elevators, emergency power, fire protection, HVAC, and sanitary system must be free of health and safety hazards, functionally adequate, operable, and in good repair.
- (4) Dwelling Units: Each LIHTC dwelling unit must be structurally sound, habitable, and in good repair. All areas and aspects of the dwelling unit (for example the unit's bathroom, call-for-aid, if applicable, ceiling, doors, electrical systems, floors, hot water heater, HVAC (where individual units are provided), kitchen, lighting, outlets/switches, patio/porch/balcony, smoke detectors, stairs, walls, and windows) must be free of health and safety hazards, functionally adequate, operable, and in good repair.

Where applicable, the dwelling unit must have hot and cold running water, including an adequate source of potable water (note for example that single room occupancy units need not contain water facilities. If the dwelling unit includes its own sanitary facilities, it must be in proper operating condition, usable in privacy, and adequate for personal hygiene and the disposal of human waste. The dwelling unit must include at least one battery-operated or hard-wired smoke detector, in proper working condition, on each level of the unit.
- (5) Common Areas: The common areas must be structurally sound, secure, and functionally adequate for the purposes intended. The basement/garage/carport, restrooms, closets, utility, mechanical, community rooms, halls/corridors, stairs, kitchens, laundry rooms, office, porch, patio, balcony and trash collection areas, if applicable, must be free of health and safety hazards, operable, and in good repair. All common area ceilings, doors, floors, HVAC, lighting, outlets/switches, smoke detectors, stairs, walls, and windows, to the extent applicable, must be free of health and safety hazards, operable, and in good repair. These standards for common areas apply to all housing but will be particularly relevant to congregate housing, independent group homes/residences, and single room occupancy units in which the individual dwelling units (sleeping areas) do not contain kitchen and/or bathroom facilities.
- (6) Health and Safety Concerns: All areas and components of the housing must be free of health and safety hazards, These areas include, but are not limited to, air quality, electrical hazards, elevators, emergency/fire exits, flammable materials, garbage and debris, handrail hazards, infestation, and lead-based paint. For example, the buildings must have fire exits that are not blocked and have handrails that are undamaged and

have no other observable deficiencies. The housing must have no evidence of infestation by rats, mice, or other vermin, or of garbage and debris. The housing must have no evidence of electrical hazards, natural hazards, or fire hazards. The dwelling units and common areas must have proper ventilation and be free of mold, odor, (e.g., propane, natural gas, methane gas), or other observable deficiencies. The housing must comply with all requirements related to the evaluation and reduction of lead-based paint hazards and have available proper certifications of such, if applicable.

The physical condition standards stated herein do not supersede or preempt applicable State and local codes for building and maintenance. A low income housing project must satisfy the local standards and ADFA is obligated to report known violations to the IRS. If there is a conflict between UPCS and state or local codes, an official of a governmental entity, such as the fire marshal's office or municipal building inspector, must provide a written notice to ADFA explaining the nature of the conflict. ADFA will evaluate and determine if the project or unit is in compliance.

## **II.F MONITORING FEE**

ADFA has implemented a two-tiered plan for collecting monitoring fees. The first plan begins with the 2009 allocations. ADFA will assess a one-time monitoring fee of 8% of the annual credit allocation for the development. This assessment is due when credits are allocated and no other monitoring fee will be due. The second tier of the plan applies to existing properties that were assessed a monitoring fee of 6% at allocation. The initial 6% fee covers the first fifteen (15) years of monitoring. Properties that are now in extended years 16 through 30+ will be assessed a fee of \$50.00 per tax credit unit. Rather than collect the fee annually, ADFA will collect this fee when ADFA conducts the audit, which is typically every three (3) years but is subject to ADFA's discretion. Qualified owners who paid the per-unit fees in 2008 but were not audited in 2008 will receive a credit for the next scheduled compliance audit.

## **SECTION III – COMPLIANCE ISSUES**

### **III.A MINIMUM SET-ASIDE**

In order for an owner to claim tax credits, a development must have a minimum number of qualified tax credit units. The owner must select one of two minimum set- asides, which establishes both the minimum percentage of tax credit units at the development and the maximum income limit used to determine tenant eligibility.

The choices are 20/50 and 40/60. Under the 20/50 selection, 20% or more of the aggregate residential rental units in the development must be occupied by persons with incomes of 50% or less of the area median gross income adjusted for family size. Under the 40/60 selection, 40% or more of the aggregate residential units in the development must be



occupied by individuals with incomes of 60% or less of the area median gross income adjusted for family size.

The owner selects the minimum set-aside when applying for the tax credit allocation and makes the election on Form 8609. Once selected, the minimum set-aside is irrevocable. The year tax credits are “claimed” determines when the minimum set-aside test must be met. The minimum set-aside test must be maintained for the entire compliance period. If the property is identified as a multiple building project on Line 8b of Form 8609, the minimum set-aside may be met across the development. If the property is not identified as such, the minimum set-aside must be met building-by-building. For 1987-1990 developments, the minimum set-aside had to be met within twelve (12) months of the placed-in-service date. For 1991 and later years, the minimum set-aside must be met no later than December 31 of the second year of the initial credit period. The minimum set-aside must be met before any credits may be claimed.

The federal minimum set-aside election must not be confused with other set-aside elections that may have earned extra points in the allocation process and are recorded in the development’s Regulatory Agreement. Additionally, the tax credit set-aside must not be confused with HOME fund requirements or subsidy programs such as Section 8 or Rural Development. Owners must always determine the tax credit minimum set-aside first and review allocation documents to identify any additional set-asides. If the development has layers of funding, the owner must satisfy the requirements of all programs. Following the most restrictive requirement may or may not apply.

### **III.B INCOME LIMITS**

The Department of Housing and Urban Development (HUD) publishes the Section 8 area median gross income (AMGI) limits annually. The IRS requires these income limits, adjusted for family size, to be used when determining eligibility of LIHTC tenants at move-in. The minimum set-aside election establishes whether the 50% or 60% AMGI limit applies to the development’s tax credit units.

HUD’s L50 Very Low Income amounts equal the 50% AMGI limits for households of one to eight persons. The 60% AMGI limit must be calculated from the 50% limits. The 60% AMGI limit equals 120% of the HUD Very Low-Income amount for the corresponding family size. Owners must calculate the 60% limits by multiplying the 50% AMGI figures by 1.2.

When HUD publishes new income limits, owners are required to implement the new income limits no later than 45 days after the effective date. Any fluctuations in the income limits will have a corresponding impact on maximum gross rent amounts. When determining income levels for qualifying tenants, the correct family size must be determined. A family includes all occupants of the unit. Owners should closely monitor family size.

Note: Owners and managers must review development files to determine if HUD or Rural Development restrictions also apply or if owner agreed to other income restrictions.

### **III.C MAXIMUM GROSS RENTS**

Units qualifying for tax credits are subject to a rent restriction formula that sets the maximum gross rent that may be charged. The maximum gross rent (including utilities) may not exceed 30% of the imputed income limitation. If low-income tenants are charged more than the allowable rent, the unit is in non-compliance and recapture of credits may result. Whenever utility costs are paid directly by the tenant, gross rent must include an allowance for utilities. Telephone and cable are not considered to be essential utilities and are not included in the allowance for utilities. See page 21 for a discussion of telephones.

**Maximum Gross Rent = (Applicable Income Limit x 30%) divided by 12. Remember that the tenant's rent plus the utility allowance cannot exceed the maximum gross rent.**

If the rent calculation ends with an amount beyond the decimal point, you must not round the amount up. Rounding up would charge more than the maximum allowable rent, thus resulting in non-compliance.

Example: If the applicable income limit is \$21,750, multiply by .30 to get \$6,525.00, and then divide by 12 to get \$543.75. You may round this amount down to \$543.00 but you cannot round up to \$544.00. The maximum gross rent including the utility allowance cannot exceed \$543.75.

#### **1987-1989 Developments**

For developments with 1987, 1988, or 1989 tax credit allocations, the unit rent is calculated using the income limit for the actual number of people in the household. Thus, the maximum rent can increase or decrease based on respective changes in the household composition.

# Persons		1	2	3	4	5	6
Income Limits	50%	12,150	13,900	15,600	17,350	18,750	20,150
	60%	14,580	16,680	18,720	20,820	22,500	24,180

The resulting maximum allowable rents (including utility allowance) based on household size equals (limit x 30%) ÷ 12:

# Persons		1	2	3	4	5	6
Rents	50%	303	347	390	433	468	503
	60%	364	417	468	520	562	604

The rent decreases based on a reduction in household composition or a decrease in the income limits.

#### 1990+ Developments

For developments with 1990 and subsequent allocations, the rent formula uses an imputed family size of 1.5 persons per bedroom to determine the applicable income limit to be used for rent calculations. For efficiency or studio units, the 1-person income limit is used.

To determine which income limit is used for the bedroom size rent formula, use the imputed household size of 1.5 persons times actual number of bedrooms.

Studio – 1 person  
 1 BR – 1.5 persons  
 2 BR – 3 persons  
 3 BR - 4.5 persons

For the 1.5 person income limit, take the 1-person limit, add to the 2-person limit and divide by 2. Multiply your answer by 30% and divide by 12 to arrive at maximum rent.

2 bedrooms:  $1.5 \times 2 = 3$ . Use the income for 3 persons  $\times 30\%$  divided by 12 = maximum rent.

3 bedrooms:  $1.5 \times 3 = 4.50$ , which means that you take the income limit for 4 persons and add to the income limit for 5 persons, divide by 2. Multiply by 30% and divide by 12 = maximum rent.

4 bedrooms:  $1.5 \times 4 = 6$ . Use the income limit for 6 persons  $\times 30\%$  divided by 12 = maximum rent.

Income Limits Sample

# Persons		1	2	3	4	5	6
Income Limits	50%	12,150	13,900	15,600	17,350	18,750	20,150
	60%	14,580	16,680	18,720	20,820	22,500	24,180

Maximum Rents Sample

# Bedrooms		0	1	2	3	4
Income Limits	50%	303	325	390	451	503
	60%	364	390	468	541	604

### **III.D FEES**

Owners/managers must be careful that gross rents do not exceed tax credit limits. A common mistake is to charge additional fees that are prohibited under the program. Prohibited fees include, but are not limited, to the following:

- Unit preparation fees
- Re-decorating fees
- Re-keying fees

Application fees may be charged to cover the actual cost of checking a prospective tenant's income, credit history, and landlord references. The fee is limited to recovery of the actual out-of-pocket costs. No amount may be charged in excess of the average expected out-of-pocket costs of checking tenant qualifications at the project. It is also acceptable for the applicant to pay the application fee directly to the third-party actually providing the applicant's rental history.

### **III.E RENT SUBSIDIES**

Gross rent does not include any housing assistance payments made to an owner to subsidize a tenant's rent (i.e. Section 8). Only the actual rent paid by the tenant, including tenant-paid utilities, is counted toward the maximum allowable rent. For example, if the LIHTC maximum gross rent is \$350.00 and the total tenant payment is \$250.00 with Rental Assistance paying an additional \$150.00 subsidy to equal the Contract Rent of \$400.00, there is no problem. The amount paid by the tenant, including utilities, does not exceed \$350.00.

### **III.F SECTION 8 RENTAL ASSISTANCE**

Under the HUD Section 8 Program, a tenant cannot pay more than 30% of his adjusted gross income for rent. For this reason, in 1989 the IRS ruled that if the tenant portion of rent increases above the LIHTC maximum allowable rent, thereby reducing the Section 8 subsidy, the higher rent may be charged. Owners must make sure the total tenant payment does not exceed the maximum LIHTC rent at time of move-in.

### **III.G RURAL DEVELOPMENT OVERAGE**

In RD 515 Projects, overage rents may result when 30% of the tenant income minus the utility allowance exceeds the RD Program's Basic Rent. If this overage rent exceeds the LIHTC rent, then the overage cannot always be charged. For 1991 and later year developments, the overage can be charged for amounts that are turned over to RD. In 1987-1990 developments, the overage cannot be charged to the tenant since the provision is not retroactive.

### **III.H UTILITY ALLOWANCES**

Utilities include the costs for heat, lights, air conditioning, water, sewer, and trash removal. Generally, telephone and cable are not included in utilities; however, if a supportive service or any other charge is mandatory, such charge becomes part of the gross rent calculation. This may include parking fees, a telephone if it is required to open the door for visitors, meal service, or other required costs. Whenever a tenant directly pays utility costs, a utility allowance must be used to determine the maximum unit rent that may be charged. The utility allowance must be subtracted from the maximum gross rent to determine the maximum tenant portion of rent. Utilities are part of rent. Overcharging rent can take the unit out of compliance even if the excessive amount is returned to the tenant.

Owners must calculate utility allowances based on one of the following:

1. HUD-regulated buildings – use HUD-approved utility allowances;
2. Rural Development-assisted building – use RD-approved utility allowances on all rent restricted units in the building;
3. Conventional building – use local Public Housing Authority utility allowances unless utility company data can support alternate amounts;
4. Conventional building with Section 8 subsidy through certificates or vouchers – owners must use the local Public Housing Authority Section 8 Existing utility allowances for those Section 8 units;
5. Utility Companies – Owners may obtain written estimates by private utility companies pertaining to comparable property of similar size, construction, and geographical area and to specific types of units (e.g. by number of bedrooms). Once obtained, a private utility estimate must be used for a building. Owners must average the utility costs for each unit type and divide by 12 to determine monthly utility allowance.

Utility allowances must be updated annually. Any changes in utility allowances have a direct impact on the net chargeable rent to the tenant. Any new allowance must be implemented within 90 days of the change. Owners must be sure that the lease indicates when and under what circumstances the rent and utilities may change.

### **III.I VACANT UNIT RULE**

If a low-income unit becomes vacant during the year, the unit remains in compliance with LIHTC regulations and eligible for the tax credit. The unit may be counted in the set-aside requirement and in determining the qualified basis provided the owner has made reasonable attempts to rent the unit or the next available comparable or smaller size unit to an eligible household and no other comparable or smaller size units in the building are rented to non-qualifying individuals.

Units that have never been occupied are termed “empty”, rather than vacant, and cannot be counted as low-income units. Empty units must be included in the building’s total unit count for purposes of counting the applicable fraction.

Throughout the compliance period, owners are required to keep records for each qualified low-income development showing the low-income unit vacancies and data for when, and to whom the next available units were rented. The vacant unit rule applies to both 100% LIHTC developments and mixed income developments.

### **III.J. NEXT AVAILABLE UNIT RULE**

If the household income for residents in a qualified unit increases to more than 140% of the current applicable income limit, the unit is considered an “over-income-unit” but may continue to be counted as an LIHTC unit as long as two conditions are met. The unit must continue to be rent restricted and the next comparable size unit in the building must be rented to a qualified low-income tenant. The owner of an LIHTC building must rent to qualified residents all comparable units that are available or that subsequently become available in the same building until the applicable fraction (excluding the over-income units) is restored to the percentage on which the credit is based. Once the original applicable fraction of the building has been restored, the “over-income” unit may remain rent restricted or may become a market-rate unit if the building is a mixed income building.

### **III.K. RELOCATING EXISTING TENANTS**

If existing LIHTC tenants wish to transfer to a different LIHTC unit in the same building (as identified by the building identification number), they do not need to be recertified. A new lease must be executed to be effective on the move-in date to the new unit. When a household moves to a different unit within the building, the newly occupied unit adopts the status of the vacated unit. Thus, if a current household, whose income exceeds the applicable income limitation moves from an over-income unit to a vacant unit in the same building, the newly occupied unit is treated as an over-income unit. The vacated unit assumes the status the newly occupied unit had immediately before it was occupied by the current resident.

As noted in Rev. Rul. 2004-82, Q&A#8, a similar rule applies when a household whose income is no greater than 140% of the income limit (or 170% for deep rent skewed projects) moves to a low-income unit in a different building within the project during any year of the 15-year credit period. The vacated unit assumes the status the newly occupied unit had immediately before it was occupied by the current resident.

During the initial credit period, existing tenants cannot be relocated for the purpose of qualifying more than one LIHTC unit to count toward the minimum set-aside or applicable fraction.

### **III.L STAFF UNITS**

Revenue Ruling 92-61 [Section A], effective 9/9/92, allows a unit for a **full-time** staff member to be considered part of a development's "common area". Such units are not classified as residential rental units and thus are not included in either the numerator or denominator of the applicable fraction under section 42(c)(1)(B) for purposes of determining the building's qualified basis.

Two options apply:

1. If the staff unit is a rental unit and is to be counted as part of the qualified basis, then the staff must be income-eligible, be certified, and sign a lease the same as any LIHTC tenant. In this case, if the staff member receives free rent or a rental discount, the imputed value of the rent or discount must be included as income.
2. If the unit is not a residential unit but used as common area by full-time staff, then the staff does not have to be income eligible, certified, leased or considered a tenant.

The bottom line is that the staff person must be full-time for the unit to be common area. The owner's application and allocation documents should specify the number of common area units set aside for staff. The Revenue Ruling does not apply to any building placed in service prior to September 9, 1992, or to any building receiving an allocation of tax credits prior to that date, unless the owner filed a tax return that is consistent with this ruling.

When contacted with a request to convert a tax credit unit to a manager's unit or security officer's unit, ADFA will send the owner a copy of Revenue Ruling 92-61 and other information on the definition and discussion of "functionally related facilities" and "functionally related and subordinate" facilities. If, based on the information, owner (not the site manager) determines that the unit(s) may be converted, then the owner must submit a written request to ADFA. The request must include:

- A statement of approval from the syndicator/investor (limited partner whose credits are at issue)
- A description of why the conversion is needed
- Statement that the staff will be full-time and indicate how the unit will be functionally related and subordinate to the development

### **III.M NON-TRANSIENT OCCUPANCY**

According to the Code, residential units must be for use by the general public and all of the units in a development must be used on a non-transient basis. For LIHTC units to be in compliance, a six-month minimum lease term is required at initial occupancy of such low-income units. A six-month lease addendum should be signed with in-place tenants who do not have six months left on an existing lease when the building is placed-in-service. The only exceptions to this requirement would be for Single Room Occupancy (SRO) housing rented on a month-by-month (30-day lease) basis or transitional housing for the homeless.

### **III.N GENERAL PUBLIC / FAIR HOUSING / SECTION 504 / ADA**

All residential rental units in the development must be available for use by the general public. LIHTC properties are subject to Title VIII of the Civil Rights Act of 1968, also known as the Fair Housing Act. This Act prohibits discrimination in the sale, rental, and financing of dwellings based on race or color, religion, sex, national origin, familial status (including children under the age of 18 living with parents or legal custodians, pregnant women and people securing custody of children under 18) and disability. However, all households must be eligible in the areas of income, occupancy, selection criteria by management, and type of property.

Tax credit units may not be provided only for members of a social organization or provided by an employer for its employees. Also, a residential unit is not for use of the general public, and therefore, does not qualify under the Code as part of a hospital, nursing home, sanitarium, life care facility, dormitory, trailer park, retirement home that provides significant services other than housing, or intermediate care facility for the disabled.

The Fair Housing Act also mandates specific design and construction requirements for multi-family housing built after March 13, 1991, to provide accessible housing for individuals with disabilities. Owners are expected to be familiar with accessibility requirements for their developments in compliance with the Fair Housing Act, Section 504 of the Rehabilitation Act of 1973, as amended, and Americans with Disabilities Act ("ADA"). Some of those pertinent facts are:

- **New Construction Requirements:** Since March 13, 1991, Fair Housing has required that downstairs units in non-elevator buildings and all units in elevator buildings be accessible.
- **Reasonable Accommodation:** The law requires that reasonable accommodations in rules, regulations, policies and procedures may have to be made for disabled applicants or residents.
- **Reasonable Modification:** The law requires that reasonable physical alterations cannot be refused to an applicant or tenant.
- **Section 504:** Section 504 of the Rehabilitation Act of 1973 covers all federal programs, including Community Development Block Grant ("CDBG"), HOME funds, RD, PHA and HUD properties. New construction and substantial rehabilitation require that a minimum of 5% of units or a minimum of one and additional 2% of units or a minimum of one be adapted for wheelchair and visual/hearing impaired respectively. All common areas must be accessible to and useable by the physically mobility impaired. While Fair Housing states that reasonable modification costs may be charged to tenants, Section 504 states it is a project expense unless it poses a financial or administrative burden. It is the owner's responsibility to provide documentation to prove financial or administrative burden.



- Fair Housing applies to all LIHTC developments. Section 504 does not apply to conventional 9% deals without other federal funds. This ruling may be subject to change. The ADA provision in regard to public accommodations would require offices and other common areas to be accessible.

The current Annual Owner's Certification being used by ADFA asks the owner to indicate if a finding of discrimination under the Fair Housing Act, 42 U.S.C. 3601-3619 has occurred for the development. A finding of discrimination includes an adverse final decision by the Secretary of Housing and Urban Development (HUD), 24 CFR 180.680, an adverse final finding by a substantially equivalent state or local fair housing agency, 42 U.S.C. 3616a(a)(1), or an adverse judgment by a federal court.

### **III.O SECTION 8 HOUSING CHOICE VOUCHERS**

Owners may not refuse to rent to Section 8 housing choice voucher holders simply because they have Section 8. On the other hand, owners must not assume a Section 8 certificate or voucher holder automatically qualifies. Applicants eligible for Section 8 may have incomes exceeding LIHTC income limits, may have negative references, or otherwise may not qualify. Proof of income eligibility must be in the tenant file.

### **III.P SUITABILITY OF UNIT**

A unit must be suitable for occupancy in accordance with state or local codes in order for credits to be claimed. If the unit is not habitable, no credits can be claimed. The IRS has ruled that if a unit is destroyed due to a casualty loss (i.e. fire, flood, or other disaster), credits cannot be claimed while the unit is being replaced. Owners must report a casualty loss to ADFA within thirty (30) days following the loss. If the building or unit is restored within a reasonable time, credits can again be claimed and no recapture would occur. What is a reasonable replacement time? The reasonableness of the time period to repair damaged property depends on the extent of the damage. ADFA will consider other factors such as the location of the property and the time of the year. Generally, however, two years should be sufficient for the replacement of property completely destroyed by a casualty loss. In the event the owner is not able to replace the property within two years, ADFA may extend the time period if the owner demonstrates that there is a reasonable cause for delay.

### **III.Q STUDENTS**

The Code specifies that LIHTC housing must be for the use of the general public on a non-transient basis. Further, the regulations state, "no dormitory...may be a qualified low income project". An LIHTC development cannot be entirely occupied by full time students. Student status becomes an issue when everyone in the household is a full-time student.

The tenant, in order to be considered a full-time student, must be (a) taking at least twelve (12) credit hours per semester; (b) taking the school's full-time requirement (as defined by

the institution); or (c) enrolled five (5) months out of 12 months in an institution of higher learning. The 5 months need not be consecutive. Student status must be re-verified at annual recertifications to confirm continuing eligibility of the household. If owner has obtained a recertification waiver, he, too, must continue to check student status annually. Student status must be verified through the registrar's office of the educational institution. Children in grades K-12 are considered full-time students.

Full-time students who are not entitled to file a joint tax return are not eligible for the tax credit unit. There is no grandfathering of eligibility because the tenant was not a student when he/she moved in and later became one.

Exceptions: A unit would not be disqualified for tax credits if it is occupied as specified in Section 42(i)(3)(D)—

(i) by an individual who is

- A student and receiving welfare (AFDC or TANF) assistance under Title IV of the Social Security Act, or
- enrolled in a job training program receiving assistance under the Job Training Partnership Act ("JTPA") or under other similar federal, state, or local laws, or

(ii) entirely by full-time students if such students are –

- single parents and their children and such parents are not dependents (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof) of another individual and such children are not dependents (as so defined) of another individual **other than a parent of such children**; or
- married and entitled to file a joint tax return.

ADFA considers a household eligible if it contains at least one part-time student. Children in kindergarten through twelfth grade are considered full-time students. The Arkansas welfare-to-work program known as Transitional Employment Assistance ("TEA") qualifies as a job training program.

#### **SECTION IV—DETERMINING TENANT ELIGIBILITY**

Owners must determine and provide documentation that proves the eligibility of potential low-income tenants in accordance with LIHTC requirements. A tenant's income eligibility is determined by comparing the household's gross annual anticipated income, calculated in accordance with HUD Section 8 guidelines, to the LIHTC 50% or 60% area gross median income limits that apply to the development. Owners must verify the household's income and the student status of all household members. The tenant and owner must certify the accuracy of the verified information. Since household composition, income, and student

status may change over time, owners must re-certify the eligibility of tenants in tax credit units annually.

#### **IV.A HOUSEHOLD SIZE AND INCOME LIMITS**

Section 42 of the Code mandates that HUD Section 8 income limits adjusted for household size be used in determining income eligibility for the LIHTC program. A household can consist of one or more persons. Members need not be related to be considered a household. Count all household members and compare to the per person 50% or 60% income limits currently in effect. Please do not confuse the 140% Rule which allows an existing tenant's income to exceed the allowable limit. Owners or managers must never allow over-income applicants to move into an LIHTC unit. Full-time students residing together in a unit must qualify under one of the exceptions previously listed herein.

Certain individuals are not considered members of the household in determining the income limits. Do NOT count the income of the following when determining household income:

1. Live-in care attendants
2. Visitors or Guests
3. Foster children
4. Foster adults

A live-in attendant or caregiver is a person who resides with an elderly, disabled, or handicapped person and who (a) is determined to be essential to the care and well-being of the person, (b) is not obligated for the support of the person, (c) would not be living in the unit except to provide the necessary supportive services, and (d) is not eligible to remain in the unit once the tenant is no longer living in the unit, regardless of the circumstances of tenant's departure. A relative may be considered to be a live-in aide/attendant IF he or she meets the above requirements. A spouse does not qualify as a live-in aide. Owners may utilize the "Live-in Care Attendant Affidavit" included as Exhibit N.

The caregiver need not sign the lease, application, or Tenant Income Certification but the caregiver should sign an agreement to abide by house rules and that the caregiver understands and agrees the eviction regulations apply to him/her. Owners may, as part of established procedures, obtain consent from the caregiver for a criminal background check. A credit check is not necessary since the caregiver is not responsible for payment of rent. If a caregiver is denied residency (i.e. because of the criminal background check), the tenant must find another appropriate caregiver.

Temporarily absent members of the household should be counted when determining household size. Count the following:

1. Children temporarily absent due to placement in a foster home

2. Children in joint custody arrangements who are present in the household 50% or more of the time
3. Children away at school but who live with the family during school recesses
4. Temporarily absent family members who are still family members (i.e. a tenant, co-tenant, or spouse is always considered to be a family member)
5. A person confined to a hospital or nursing home for periods of limited or fixed durations
6. For persons permanently confined to a hospital or nursing home, the family decides if such persons are included when determining household size for income limits.
7. A son or daughter on active military duty only if this person leaves dependents or a spouse in the unit.

ADFA counts unborn children and children who are in the process of being adopted as household members for the purposes of determining unit size and income limits only.

**Changes in household Size:** No additions may be made to the household during the first six (6) months of the lease unless such change was indicated on the application. After the initial six months, the addition of new household members to an existing low-income household requires the Tenant Income Certification (TIC) for the new member of the household, including third party verification. The new tenant's income is added to the income disclosed on the existing household's TIC. The household continues to be income-qualified and the income of the new member is taken into consideration with the income of the existing household for purposes of the Available Unit Rule under IRC §42(g)(2)(D). The effective date continues to be the original move-in date and the next recertification is due within 120 days before the original move-in date.

A household may continue to add members as long as at least one member of the original low-income household continues to live in the unit. Once all the original tenants have moved out of the unit, the remaining tenants must be certified as a new income-qualified household unless the remaining tenants were income qualified at the time they moved into the unit. A household may be originally qualified based on the inclusion of an unborn child but the pregnancy ends in miscarriage. It is not necessary to certify the remaining household as a new tenant at the time of the miscarriage. If the income of the remaining household members exceeds the income at the next income recertification, the Available Unit Rule is applicable.

#### **IV.B. GROSS ANNUAL INCOME**

Total income is gross income with no adjustments or deductions. Tenant income is calculated in a manner consistent with the determination of annual income under Section 8 of the United States Housing Act of 1937 ("Section 8"), not in accordance with the determination of gross income for federal income tax liability. Annual income is the anticipated total income from all sources received by the family head and spouse (even if temporarily absent) and by each additional member of the family, including all net income derived from assets for the 12-month period following the effective date of certification of income. Certain types of income are excluded.

The LIHTC Program refers to the current HUD Handbook 4350.3 in utilizing its definition of income only. Keep in mind that the LIHTC program is governed by Section 42 of the Internal Revenue Code. Owners or managers of mixed-use properties must comply with all applicable program regulations. Allowances used in some government programs, such as childcare, elderly status, medical expense, etc., are not deducted from the household's gross annual income to determine income eligibility for LIHTC units. Owners must review the current version of the HUD Handbook 4350.3 for a comprehensive discussion of income calculations.

**Annual income includes:**

1. (a) The gross amount (before any payroll deductions) of wages and salaries, overtime pay, commissions, fees, tips, bonuses, and other compensation for personal services of all adults of the household (including persons under the age of 18 who are the head, spouse, or co-head). Includes salaries of adults received from family-owned businesses.  
(b) Net income, salaries and other amounts distributed from a business.
2. Interest, dividends, and other net income of any kind from real or personal property (including income distributed from a nonrevocable trust). This includes any withdrawal of cash or assets from an investment, except to the extent the withdrawal is reimbursement of cash or assets invested by the family. Where the family has net family assets in excess of \$5,000, annual income includes the greater of the actual income derived from all net family assets or a percentage of the value of such assets based on the current passbook savings rate, as determined by HUD. The current passbook rate is 2 percent (.02).
3. The gross amount (before deductions for Medicare, etc.) of periodic social security payments (including the cents-do not round down). This includes payments received by adults on behalf of minors for their own support. Note: If Social Security is reducing a family's benefits to adjust for a prior overpayment, use the amount remaining after the adjustment for the overpayment.
4. The full amount of periodic payments of annuities, insurance policies, retirement funds, pensions, disability or death benefits and other similar types of periodic receipts, including a lump sum amount or prospective monthly amounts for the delayed start of a periodic amount (other than deferred periodic amounts from Supplemental Security Income and Social Security benefits that are received in a lump sum amount or in prospective monthly amounts). Count the total amount received. Do not reduce the amount by any amounts the individual previously paid into the account in order to receive the pension, annuity or insurance policy.
5. Payments in lieu of earnings, such as unemployment and disability compensation, workers' compensation and severance pay, including delayed periodic payments received that would have been paid periodically but were paid in lump sum because of circumstances such as processing delays. Count any payment that will begin during the next 12 months.
6. Welfare Assistance: If the payment includes an amount specifically designated for shelter and utilities and the welfare agency adjusts that amount based upon what the

- family is currently paying for shelter and utilities, special calculations are required. If the welfare agency is reducing a family benefits to adjust for a prior overpayment, use the amount remaining after the adjustment for the overpayment.
7. Alimony and child support awarded to the household, unless the applicant certifies that payments are not being made and has taken all reasonable legal actions to collect amounts due, including filing with the appropriate courts or agencies responsible for enforcing payment.
  8. Alimony or child support **paid** by a member of the household is counted as income (not deducted from the income of the party paying such alimony or child support), even if it is garnished from wages. For example, John Smith pays \$150 per month in child support. It is garnished from his monthly wages of \$950. After the child support is deducted from his wages, Mr. Smith receives \$800. The owner must count \$950 as John smith's monthly income.
  9. Recurring monetary gifts or contributions regularly received from persons not living in the unit. Except, exclude from annual income recurring monetary contributions that are paid directly to a child care provider by persons not living in the unit.
  10. Lottery winnings paid in periodic payments. (Lottery winnings paid in a lump sum are included in net family assets, not in annual income).
  11. All regular pay, special pay and allowances (including housing allowance) of a member of the Armed Forces (except the special pay to a family member serving in the Armed Forces who is exposed to hostile fire).
  12. Relocation payments made pursuant to Title II of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970.
  13. Actual income distributed from trust funds that are not revocable by or under the control of any member of the tenant family. NOTE: Even if family assets exceed \$5,000, use actual income distributed from the irrevocable trust.
  14. Student financial assistance in excess of tuition: For any student under the age of 24 who is seeking housing without his or her parent, financial assistance in excess of amounts received for tuition under the Higher Education Act of 1965, from private sources, or from an institution of higher education, shall be considered income to that individual, except for persons over the age of 23 with dependent children. Financial assistance does not include loans.

For any student residing with his or her parents, scholarship, grants, fellowships, educational entitlement, or any other student financial assistance paid directly to a full-time student or directly to an institution, no matter how the assistance is used, is excluded from income. Amounts of scholarships funded under title 1C of the Higher Education Act of 1965, including awards under federal work-study programs or under the Bureau of Indian Affairs student assistance programs are excluded.

Tuition includes whatever the school declares as tuition. Do not add any amounts for books, fees, or other expenses that may be itemized separately on the verification form. NOTE: if you have a Section 8/Section 42 combination on the property, the student must qualify under

both programs to get the benefits of both programs. If family members are students and qualify for Section 8 but the entire household consists of full-time students and none of the Section 42 exceptions apply, tax credits cannot be claimed on the affected units.

**Some Common Income Exclusions are listed below. Please refer to the current HUD Handbook 4350.3 for a comprehensive list.**

1. Income from the employment of children (including foster children) under the age of 18.
2. Payments received for the care of foster children or foster adults. (Foster adults are usually adults with disabilities, who are unrelated to the tenant family, and who are unable to live alone).
3. Income of live-in care attendants.
4. Meals on wheels or other programs that provide food for the needy; groceries provided by persons not living in the household.
5. The principal portion of the payments received on mortgages or deeds of trust.
6. The special pay to a family member serving in the Armed Forces who is exposed to hostile fire.
7. Temporary, nonrecurring or sporadic income.
8. Annual rent credits or rebates paid to senior citizens by government agencies.
9. Lump sum additions to family assets, such as inheritances, insurance payments (including payments under health and accident insurance and workers compensation) capital gains and settlement for personal or property losses (other than payments in lieu of earnings, such as unemployment and disability compensation).
10. Amounts received by the family that are specifically for, or in reimbursement of, the cost of medical expenses for any family member.
11. Income from training programs: Compensation from state or local employment training programs or training of a family member as resident management staff is not included in income. Income from training programs not affiliated with a local government and income from the training of a family member resident to serve on the management staff are also excluded. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for a limited period as determined in advance under the program by the state or local government.
12. Amounts received under training programs funded by HUD are not included in income. Similarly, payments received under programs funded in whole or in part under the Workforce Investment Act (WIA – formerly the Job Training Partnership Act) are excluded from income. These are employment and training programs for Native Americans and migrant and seasonal farm workers, Job Corps, veterans employment programs, state job training programs, career intern programs, and Americorps. Amounts received by a person with a disability that are disregarded for a limited time for purposes of supplemental security income eligibility and benefits because they are set-aside for use under a Plan to Attain Self-Sufficiency (PASS) are excluded from income.

#### **IV.C ASSETS**

The net income from assets must be considered when determining the tax credit eligibility of a household. Asset information for all household members (including minors) should be obtained at the time of application. Please refer to the latest revision of HUD Handbook 4350.3 for a discussion of assets.

For LIHTC Program purposes, third party verification of assets is required only if assets exceed \$5,000.00 per household. ADFA will accept the “Under \$5,000 Asset Certification” included herein as Exhibit K for tax credit units only. Under the HOME or other federal programs, all assets, regardless of value, must be documented by third party verification. For example, if a tax credit unit is also HOME-assisted, the owner must comply with the stricter HOME verification requirement.

The “Under \$5,000 Asset Certification” must be completed accurately. There should be no blank lines. Owners or managers should always question the reasonableness and compare the amounts on the form to the application.

If net family assets total \$5,000 or less, owners must count the actual income derived from net family assets. If net family assets exceed \$5,000, owners must impute the asset income by multiplying the net family assets amount by the passbook rate specified by HUD, which is currently 2 percent (.02). The income to be included in household income will be the greater of (a) actual asset income, or (b) the imputed income from assets.

At each certification and re-certification, applicants and tenants must declare whether or not an asset has been disposed of for less than fair market value during the two years preceding the date of application or the effective date of the re-certification. An asset is considered to be disposed of for less than fair market value if the cash value of the disposed asset exceeds the gross amount the family received by more than \$1,000.00. If it does, for a period of two years owners must include in the total household assets the difference between the cash value of the asset and the amount received. For examples of assets disposed of for less than fair market value, you should refer to the latest revision of HUD Handbook 4350.3.

#### **IV.D TENANT APPLICATION PROCESS**

Because the LIHTC program uses special definitions for income, assets, and household composition, standard property management application forms may not collect sufficient information to determine tenant eligibility. A comprehensive housing application is critical to the accurate identification of full-time students, all assets, and anticipated income sources. An updated sample application form is included in this manual as Exhibit C.

Owners or managers must review all information furnished on the fully completed Application for Housing, including any supplementary historical documents (i.e. most recent 1040 tax form, divorce decree, etc.). The application procedure must include an interview



with all adult household members to review the application and historical documents and clarify any discrepancies or missing information. For example, if the 1040 form and W-2 forms show two employers but the application only lists one, owners must ask about the second job and confirm its termination. One application signed by all co-applicants should be submitted per household. Non-related roommates should submit separate applications. If a delay of 90 days occurs between application and move-in, the owner or manager should take another application.

#### **IV.E TENANT INCOME VERIFICATION**

Owners/site managers must remember that the HUD Handbook 4350.3 is the reference guide to be used for identifying income to be included or excluded when determining household income. Determination of annual income of individuals and area median gross income must be made in a manner consistent with HUD Section 8 income definitions and guidelines.

The earned income of every prospective household member aged 18 or older must be verified. Unearned income, assets and asset income of all household members, including minors, must be verified. Verifications must be received by the owner or site manager prior to the execution of the certification of tenant eligibility and lease.

Third party verifications are valid for 120 days before the effective date of the TIC. Owners may not rely on verifications that are more than 120 days old. After this time, a new written verification must be obtained.

Written third party verifications are preferred. An authorization to release information must be signed by the applicant and must accompany verification requests. Owners must send verifications directly to the source and the source must return them directly to the owner. **Verifications must not be hand-carried by the applicant to or from the source.** The owner may obtain acceptable third party written verifications by facsimile, e-mail, or Internet. If written verification is not possible, direct contact with the source, in person or by telephone, is acceptable. The owner must document this verbal verification in the tenant file and must obtain all information as requested on the written verification form.

#### **IV.F TENANT INCOME CERTIFICATION (TIC)**

When all the income and asset verifications have been received, the owner/manager must record and compute the 12-month anticipated income and income from assets of adult occupants and reconcile to amounts on the verifications. If the total 12-month projected income is less than or equal to the maximum allowable qualifying income in effect at the time of tenant certification, the household is income-eligible for a tax credit unit. If the household income exceeds the maximum allowable qualifying income, the household cannot be certified eligible for a tax credit unit. If it is determined that all requirements for eligibility are met, the Certification of Tenant Eligibility must be completed and executed along with the lease prior to move-in. All adults (age 18 or older at time of move-in) must sign the lease

and TIC prior to move-in. The Tenant Income Certification must be completed in ink or by computer. ADFA will not accept strikethrough lines or the use of white out on the TIC. If errors are discovered before all parties sign, a new TIC must be prepared. If errors are discovered after all parties have signed, ADFA will accept a properly executed addendum with corrections or a new TIC.

The effective date of the LIHTC Tenant Income Certification (TIC): Section 42 of the Code specifies that the LIHTC TIC is effective on the date the unit is designated as a low-income unit, i.e., the date a qualified household occupies the unit. For example, John and Jane Doe completed a rental application on April 12, 2004. The property manager determined the household to be eligible on April 21, 2004. John and Jane Doe signed the rental lease on April 25<sup>th</sup>, and took possession of the unit on May 1, 2004. The effective date of the LIHTC certification is May 1, 2004. All subsequent recertifications must be performed within 120 days of May 1<sup>st</sup> of each subsequent year of the compliance period.

Managers must be aware of the tax credit effective date and be sure to re-certify within 120 days of the anniversary of the tax credit certification date. Do not move the effective date forward to accommodate other programs. Please refer to Section IV.I on Recertifications for additional information.

#### **IV.G WAITING LISTS**

The waiting list is required as part of the selection process. No one should be placed on the waiting list unless he has submitted a completed application. All applications should be logged by date and time received. The waiting list should have columns for bedroom size, need for subsidy (if available), any other program priorities, need for accommodations for disabled persons, gross income, etc. If the owner has more than one income level in the LIHTC property, the owner must keep appropriate lists or columns by 30%, 50%, 60%, or other income limit.

#### **IV.H THE LEASE**

All tenants occupying tax credit units must be certified and under lease no later than the date the tenant takes possession of the unit. All parties must sign the lease by the beginning of the lease term date to be properly in effect and the unit in compliance.

Some leasing guidelines are as follows:

A. The lease should include, but is not limited to:

1. The legal name of all parties to the agreement and all additional occupants
2. Identification of the unit to be rented (number, street address, etc.)
3. The date the lease becomes effective
4. The term of the lease

5. The amount for rent—if this reflects a contract rent amount that may include a subsidy payment rather than just the tenant portion of the rent, a lease addendum listing only the tenant share of rent is recommended.
  6. The rights and obligations of the parties, including the obligation of the tenant to recertify income annually (or more frequently as required)
  7. Language addressing changes in income, utility allowance, income limits, basic rent (RD or HUD 236 projects), family composition or any other change and its impact on the tenant's rent
  8. The consequences of fraudulent reporting of income, asset, or household composition
  9. The prohibition of Subletting
  10. The prohibition of commercial business in a unit
  11. Signature and dates
- B. The tenant portion of rent plus utility allowance and other mandatory fees must not exceed the maximum gross rent allowed by Section 42 of the Code.
- C. The initial lease term must be at least six (6) months on all tax credit units, except for SRO housing, which may have a 30-day lease, or transitional housing for the homeless. Succeeding leases are not subject to a minimum lease term.

In addition to the lease, ADFA recommends that owners or managers get the tenants to sign a Tenant Agreement. The Tenant Agreement specifies the development's rules with which the tenant is expected to comply. For example, the Tenant Agreement may include, but is not limited to, the following:

- Tenants must cooperate with management during the re-certification process
- Smoke alarms must not be disconnected
- Tenants must keep their units clean and sanitary and must permit inspections by management and ADFA
- Use of illegal substances on the premises will not be tolerated and will be grounds for eviction
- Tenants must comply with rules and regulations of the LIHTC Program
- Any other legitimate reasons for eviction

#### **IV.I. RECERTIFICATION**

Section 42 of the Code requires that recertification of residents be completed on at least an annual basis. Annual recertification is crucial in identifying the 140% rule situation, student status, and household composition changes. The 140% Rule is discussed in Section III.J. The procedure for annual recertifications is virtually the same as determining initial income eligibility. Owners/managers must contact the tenant and obtain an application with an accurate count of the current number of household members; information about student status of each member of the household; an accurate list of income sources, including assets, for the coming year ; and tenant's written authorization to verify household income, assets, etc. Owner/manager will compare income to 140% of the current income limit. Any changes in

household size must be reflected. If the household's income at recertification exceeds 140% of the income limit, the available unit rule will apply. The preferred method for income verification is third-party written verification. If third-party verification is impossible (e.g. self-employed, extended delay, etc.) owners or managers must obtain and review appropriate alternative documentation.

Failure to recertify tenants on an annual basis is cause for ADFA to issue IRS Form 8823 Report of Non-Compliance. The timing of the recertification is critical to maintaining compliance with the tax credit program. Subsequent recertifications must be completed within 120 days of the anniversary of the move-in date. When additional adult individuals join the household, the effective date will remain the same until the unit is completely vacated.

#### **IV.J RECERTIFICATION EXCEPTION FOR 100% LIHTC PROPERTIES**

Regulations now eliminate the annual income recertification requirement for 100 percent qualified unit developments, applicable for years ending after the date of enactment of HR 3221. ADFA will provide additional information on this provision.

#### **IV.K ACQUISITIONS OR REHABILITATIONS**

For households occupying a unit at the time of acquisition by the owner, the initial tenant income certification is completed within 120 days after the date of acquisition using the income limits in effect on the day of acquisition. The effective date of the tenant income certification is the date of acquisition since there is no move-in date.

In the event that the household occupies a unit at the time of acquisition, but the tenant income certification is completed more than 120 days after the date of acquisition, the household is treated as a new move-in. Owners use the income limits in effect at the time of the tenant income certification and the effective date is the date the last adult member of the household signed the certification (this is an exception to the general rule for effective dates because there is no move-in date).

When the household moves into a unit after the building is acquired but before the beginning of the first year of the compliance period, the tenant income certification is completed using the income limits in effect at the time of the certification and the effective date is the date the household moves into the unit.

Under IRC 42(f)(2), the applicable fraction for the first year of the credit period is computed based on a month-by-month accounting of units or floor space occupied by income-qualified households. In the case of buildings that were acquired and then rehabilitated, there are two separate allocations of credit documented on two Forms 8609; one for the acquisition credit and a separate allocation for the rehabilitation credit. The owner is not required to determine two applicable fractions. Under IRC 42(e)(4)(B), the

applicable fraction for the substantial rehabilitation credit will be same as the applicable fraction for the acquisition credit. Therefore, for purposes of computing the applicable fraction under IRC 42(f)(2), the following units are considered low-income units:

1. Units occupied before the beginning of the credit period, which are determined to be low-income units at the beginning of the credit period under Rev. Proc. 2003-82.
2. Units initially occupied after the beginning of the credit period by newly certified income-qualified households (regardless of whether rehabilitation costs have been incurred for the unit).
3. Units occupied by income-qualified households that moved from other units within the project. The household's lease and tenant income certification (with effective date) move with the household.
4. Vacant units that are suitable for occupancy under IRC 42(i)(3)(B)(ii) and were previously occupied by an income-qualified household, regardless of whether rehabilitation costs have been incurred for the unit during the first year of the credit period.

Units are not included in the numerator of computation of the applicable fraction if:

1. The unit is occupied by a nonqualified household;
2. The unit is vacant and was last occupied by a nonqualified household;
3. The unit is not suitable for occupancy. Units not suitable for occupancy are considered out of compliance. The noncompliance is corrected when the unit is again suitable for occupancy.

#### **IV.L QUALIFYING SECTION 8 TENANTS**

For HUD Section 8 tenants only, Treasury Regulations permit the submission of a letter from the contract administrator (e.g., local PHA) as verification that the family's income does not exceed the applicable Section 42 income limitation. ADFA will accept the form "Verification of Annual Income and Household Size", included herein as Exhibit Q. This form is a verification of income; it is NOT a substitute for the Tenant Income Certification (TIC), which must be executed for every LIHTC household. Upon receipt of the Exhibit Q, owner or manager must ensure the form is completed in its entirety and dated within the appropriate timeframe. The combined annual family income must be compared to the LIHTC income limit to ensure it falls at or below the limit. Any discrepancies between the application and income certified by the PHA will necessitate the use of third party verifications for all income. Owners or managers must remember that full-time student household eligibility must be verified.

#### **IV.M DEFINING ELDERLY HOUSING**

The Fair Housing Law states that there are three types of Elderly housing:

1. Federal or State programs that the Secretary of HUD has recognized as being Elderly so long as the definition of the program is followed. FmHA (RD), HUD and PHA Elderly housing programs fall under this category. In these programs, the definition of Elderly is the tenant or co-tenant must be 62 or older or disabled if the disabled tenant is of legal age. In these programs, children are allowed if they are members of the Elderly household. In such “Elderly” properties, many disabled applicants with or without children have been housed based on this definition. If a Federal Agency or a State government program wishes to create another elderly program that does not follow one of the two remaining choices in the Law, then that definition must receive a waiver from the Secretary of HUD.
2. 62 and older housing—This is the most restrictive type of Elderly housing since every resident must be 62 or older. In other words, if an applicant who was 63 applied with a spouse or household member who was 61, the applicants would be ineligible for this type of housing. Children are not allowed nor are disabled persons or other applicants who are under 62.
3. 55 and older housing—This type of property is recognized as Elderly if one household member is 55 or older in at least 80% of the units at all times. The remaining 20% of the units may be rented to households other than age 55 plus. An applicant household consisting of a 57- and a 52-year-old applies, the 57-year-old later leaves or dies, with the remaining member under 55 certainly allowed to stay. There are two important things to recognize under Fair Housing. The first is that age is not a Fair Housing protection, so an owner may limit the age of other household members to, for example, 50 or require that everyone be 55 or that all 100% of the units have at least one 55-year-old tenant. In fact, if an owner wished to turn 55-plus housing into 60, 62, 65 or another age plus housing, it would still meet the requirements of the Law since these ages are obviously over 55. The second item to note is that in 55-plus housing, there must be at least one service or amenity that would benefit the elderly. This could be a van for transportation to shopping or doctors, meals programs, specific seniors’ activities on a regular basis or other services that would distinguish this property as Elderly housing.

New occupants must meet the age requirements. Vacant units must be reserved for occupancy by persons who meet the age requirements.

## **SECTION V— LIHTC RECORD RETENTION**

The owner must retain the original tenant files (with original signatures), monthly unit data tracking and development files for the first year of the credit period for a minimum **21 years**. First year records must be maintained in addition to any copies on discs or other electronic devices. All other records must be retained for at least 6 years after the due date (with extensions) for filing the federal tax return for that year. Owners must keep records throughout the Compliance Period, which is usually 15 years. Those owners who have

executed a Land Use Restriction Agreement (“LURA”) must maintain records throughout the extended Compliance Period, which is usually an additional 15 years, for a total of **30** years.

## **SECTION VI –NON-COMPLIANCE**

Any determinations of non-compliance, including owner’s failure to certify, will be communicated to the owner in writing. The non-compliant conditions must be corrected within the period specified by ADFA. Generally, there is a maximum of sixty (60) days to correct items of non-compliance. Violations of general health, safety and sanitary conditions may require immediate corrective measures. ADFA will notify the Internal Revenue Service of any non-compliant conditions no later than forty-five (45) days after the end of the allowed correction period, whether or not those conditions are corrected. ADFA will utilize IRS Form 8823, attached hereto as Exhibit D when reporting non-compliance or corrections. ADFA reserves the right to request additional information, if necessary. ADFA, in its sole discretion, may schedule additional follow-up visits.

Non-compliance may be described as a period of time during which the owner failed to follow proper procedures for the development, specific building, or unit. Non-compliance may lead to recapture of tax credits by the IRS for a given period of time.

Most non-compliance issues as identified by IRS may be found on the IRS Form 8823. Generally, non-compliance issues can occur for:

- Inadequate certification documents
- Failure to obtain and retain proper income verifications
- Missing signatures
- Late certifications or certification signature dates
- Lease issues, i.e., not signed, late or no 6-month term
- Failure to recertify by the LIHTC-required anniversary date
- Failure to furnish year-end documentation on time
- Failure to respond to requests for additional information
- Incomplete recordkeeping
- Failure to identify full-time students
- Failure to maintain and update utility allowance documentation
- Charging unrestricted rents
- Failure to maintain the minimum set-aside
- Any change in the applicable fraction or eligible basis that results in a decrease in the qualified basis
- Housing an ineligible tenant
- Failure to satisfy Special Needs or Additional Low-Income Housing Set-Asides
- Failure to use appropriate forms
- Failure to notify ADFA of disposition of ownership interest.

This list is not meant to be all-inclusive.

## **VIA RECAPTURE OF TAX CREDITS**

The most serious action the IRS can take against an ownership is the recapture of credits previously claimed. Only the IRS determines this course of action. ADFA does not determine the consequences of reported non-compliance. If the owner discovers at any time that credits have been claimed in error, miscalculated, or the basis was incorrectly listed, owner must complete IRS Form 8611 included herein as Exhibit E.

## **SECTION VII –CHANGE OF OWNERSHIP**

Subject to the requirements of Section 42 of the Code and the LURA, the owner must notify ADFA in writing thirty (30) calendar days prior to the contemplation of any sale, transfer, or exchange. The notification must include a copy of the letter of intent of any buyer, successor or other person intending to acquire the development or any interest therein. In addition, the notification should address the requirements of the LURA and provisions allowing the transfer under Section 42 of the Code and the regulations therein. This information must be presented to ADFA for approval. Approval is not guaranteed. The owner agrees that ADFA may void any sale, transfer or exchange of the development if the buyer or successor or other person fails to assume in writing the requirements of the Code and the LURA and for other valid reasons. It is understood and agreed that any changes to the original application must be submitted to ADFA in writing for review and approval. Any changes made without prior approval could jeopardize the issuance of tax credits for the project or owner's continued participation in the program.

ADFA is required to issue IRS form 8823, Report of Non-Compliance or Building Disposition, for all building dispositions to advise the IRS of a change in ownership. Owners must advise ADFA in writing the name, tax identification number, address and telephone number of the new owner. New owner must obtain first year records and all other pertinent records from the previous owner.

Owners who are considering disposing of their buildings or an interest therein should consult a tax adviser about posting a disposition bond or other requirements related thereto.

## **SECTION VIII – CHANGE IN MANAGEMENT**

~~The owner, not the management company, is responsible for submitting a written request to ADFA prior to the anticipated change in management companies. The request must be provided at least thirty (30) calendar days prior to the effective date of the change in management to allow time for consideration of the request. ADFA, in its sole discretion, may approve or deny the request. The owner will be notified of the decision by ADFA's Board of Directors regarding changes in management.~~

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~~The owner's letter of request must include the following:~~

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- ~~• Reason for the change~~
- ~~• Name and address of new management company~~
- ~~• Name and telephone number of contact person~~
- ~~• Brief biography of the officers of the new management company~~
- ~~• List of other staff, including the onsite manager, along with a list of titles, duties, and certifications~~
- ~~• Statement from owner that local staff will attend a training session with ADFA staff within 90 days of employment~~
- ~~• Effective date of change~~
- ~~• A list of all properties (if more than one) affected by the change~~
- ~~• A list of other LIHTC or HOME assisted properties currently managed by the new company and the states in which the properties are located~~

ADFA staff must be informed on a current basis of the management entity and personnel responsible for ensuring Compliance with all applicable laws, rules, policies, etc. To facilitate that notification requirement, the process for requesting ADFA approval of any change in management will include the submission of: 1.) the proposed Management Plan, 2.) Management Certification, and 3.) Previous Participation form. In order to obtain Board approval, project owner must submit request 45 days before the anticipated effective date of the new management contract. Owner should NOT enter into a formal contract without ADFA's approval.

Any Owner who engages a management company without first obtaining ADFA approval will be considered noncompliant. Such noncompliance must be remedied by:

- 1.) Notifying management company of the noncompliance created by their engagement.
- 2.) Immediately submitting the required documentation requesting ADFA approval of the new management company as outlined above.
- 3.) Providing a written explanation of the cause for the owner failing to obtain ADFA approval of a change in management and delineate actions to prevent the noncompliance from recurring.

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The owner's adherence or failure to adhere to these policies will be considered as ADFA reviews and evaluates any future request from the owners.

~~If approval is granted, the following requirements apply:~~

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- ~~• The compliance officer of management companies new to the state of Arkansas must attend a compliance workshop conducted by ADFA compliance staff to review management obligations under the LIHTC Program.~~
- ~~• Management staff responsible for certifying tenants for LIHTC units must be certified in LIHTC compliance requirements by one of the nationally recognized training companies.~~
- ~~• New Managers hired for existing LIHTC properties must attend a compliance workshop conducted by ADFA compliance staff.~~

~~ADFA's approval of any change in management will be contingent on management strictly adhering to the requirements of this section. ADFA, in its sole discretion, will determine any penalties assessed for noncompliance with these requirements. The owner of the development should be aware that noncompliance with the requirements of Section VIII., Change in Management, may jeopardize his future participation in programs administered by ADFA. Accordingly, if penalties are assessed for noncompliance, ADFA will comply with all relevant adjudicatory procedures.~~

## **SECTION IX – FORMS**

ADFA has adopted certain standardized forms for its compliance monitoring. You may access the website for samples or call the Compliance Department. If no sample is provided for a specific form, ADFA will accept the owner's forms or forms utilized by HUD or Rural Development, provided such forms substantially comply with LIHTC rules for data collecting. Use of the LIHTC Tenant Income Certification (TIC) is mandatory.

## **SECTION X – LIHTC PROPERTIES AND OTHER PROGRAMS**

Housing credit properties may receive assistance from other federal or state housing programs. ADFA is the monitoring agency for the HOME Investment Partnerships Program (commonly known as "HOME"). ADFA also is the monitoring agency for ADFA-issued tax-exempt bonds. If the housing credit requirements differ from those of other programs, owners or managers must follow the most restrictive requirements

### **X.A Combining Low Income Housing Tax Credits with HOME Funds**

Rental projects that combine HOME funds with Low Income Housing Tax Credits (LIHTC) must be structured to ensure compliance with the requirements of both programs.

Tax credit projects must meet one of two minimum set-asides: 20/50 or 40/60. 20/50 means that at least 20 percent of the units must be rented to tenants with incomes at or below 50 percent of the area median income. The 40/60 set-aside means that at least 40 percent of the units must be rented to tenants earning at or below 60 percent of area median income. When combining HOME and tax credits, occupancy requirements depend on the type of credit taken and the type of HOME funding provided.

In order to take the 9 percent credit in conjunction with below-market HOME loans, joint HOME/tax credit projects must meet a higher occupancy standard than either the tax credit program or the HOME program. Together, they require 40 percent of the units to be occupied by tenants with incomes at or below 50 percent of area median income. Such projects are not eligible for the 130 percent increase in basis for projects in “qualified census tracts” or “difficult development areas”. To receive the 130 percent increase, the project must either take the 4 percent credit or use the HOME funds at or above the applicable Federal rate.

In all other cases (when HOME funds are provided in some form other than a below-market interest rate loan) projects must ensure that they meet both sets of program rules. For example, a project receiving a market-rate loan can comply with both sets of rules by establishing a 20 percent set-aside for households with incomes at or below 50 percent of the area median income (as long as all remaining HOME-assisted units are leased to tenants with incomes at or below 80 percent of the area median income).

#### **RULES FOR COMBINING HOME FUNDS AND LIHTC**

	Tax Credit Rule	Combining Tax Credits with HOME
Occupancy Requirements	At least 20 percent of units must be reserved for households with incomes at or below 50 percent of area median income OR 40 percent of the units must be reserved for households with incomes at or below 60 percent of area median income.	If HOME funds are provided at below the market interest rate, at least 40 percent of the units must be reserved for households with incomes at or below 50 percent of area median income to qualify for the 9 percent credit. Otherwise, at least 20 percent of units must serve households at or below 50 percent of area median income to meet HOME requirements.
Rent Requirements	Rents for qualified units must not exceed the rent limit set for the LIHTC	For units to qualify as both tax credit and HOME-assisted units, rents cannot

	program. HUD limits are set by bedroom size and are based on the qualifying incomes of an imputed household size.	exceed either program limit. Low HOME rent units are subject to Low HOME rents and tax credit limits, whichever is lower. High HOME rent units are subject to High HOME rents and tax credit limits, whichever is lower.
Establishing Tenant Eligibility	<p>Documentation: All sources of income must be verified. Acceptable documentation of income must be provided.</p> <p>Definition: The tax credit program defines income using the Section 8 definition of annual gross income.</p> <p>Asset Income: Assets of \$5000 or less: tenants certify asset amount and income. Use actual income.</p> <p>Assets above \$5000: verify amount and income. Use larger of actual income from assets or imputed asset income</p>	<p>Documentation: Initial tenant eligibility documentation for both programs is the same. Use the Section 8 definition of income.</p> <p>Definition: Use the Section 8 definition of income.</p> <p>Asset Income: Follow more stringent HOME rules and verify all asset income.</p>
Reexamination of Income	Re-examinations are performed annually following the same procedures as at initial certification.	The project must follow the more stringent tax credit requirements.
Over-Income Tenants	Rent for over-income tenants remains restricted.	HOME rules defer to tax credit rules-rent remains restricted. In no case can the rent exceed limits set by the tax credit program.
Monitoring	Over-income is defined as 140 percent of the project rent limit.	ADFA will monitor HOME/tax credit projects in accordance with

		<p>guidelines of each program. In case of a conflict, the more stringent rule will apply.</p> <p>ADFA will monitor rental projects based on total number of units and annually for other HOME-assisted projects.</p> <p>The HOME affordability periods are as follows: up to \$15,000=5 years \$15,000-\$40,000=10 years; \$40,000 or more= 15 years. For a refinance of Rehabilitation project=15 years; New construction=20 years.</p> <p>Recipients must submit Project Compliance Reports annually for HOME units and LIHTC Owners Certification and occupancy status reports.</p>
	<p>Projects are monitored by the second year the last building of the development is placed in service and once every three years throughout the affordability period. A random selection of 20 percent of tenant files and units will be reviewed.</p> <p>Affordability Period: IRS mandates a 15-year affordability period. Developers will extend the affordability period an additional 15 years, for a total of 30 years, by terms of a land use restriction agreement.</p> <p>Owners must submit a statement of compliance annually along with occupancy status reports.</p>	

### **X.B Tax-Exempt Bonds**

ADFA, as issuer of certain tax-exempt bonds, will monitor those projects that combined tax credits and tax-exempt bonds. ADFA will monitor those projects in accordance with the terms and conditions of specific Regulatory Agreements and applicable LIHTC program requirements.

The bond issuer, rather than the project owner, may make the election to satisfy the 20-50 test or the 40-60 test at the time the bonds are issued. This election may be entirely separate from the choice of minimum set aside for LIHTC purposes. Thus, it is not impossible that an issuer will elect the 20-50 test for a bond issue, while the project owner elects the 40-60 test for the LIHTC project financed by those bonds. Of course, the project would have to satisfy both the 20-50 test for bond purposes and the 40-60 test for LIHTC purposes. The rent

restriction must comply with the terms of the Regulatory Agreement but must not exceed the LIHTC limit.

The property that is financed with both tax-exempt bonds and low income housing tax credits must comply with both programs. While some rules overlap, such as the 20/50 or 40/60 minimum set aside, the programs do not exactly match. The owner is responsible for knowing and complying with both sets of requirements.

#### **RULES FOR COMBINING LIHTC AND TAX-EXEMPT BONDS**

	LIHTC Rule	Tax Exempt bonds		
Compliance Period	The compliance period for LIHTC projects is a period of 15 taxable years beginning with the first taxable year of the credit period. Additionally, 15 or more years are mandated in extended use agreements.	The compliance period (qualified project period) is the period beginning on the date of issuance of the bonds and ending on the latest of: <ul style="list-style-type: none"> <li>(a) the date which is 15 years after the date on which 50% of the dwelling units are occupied;</li> <li>(b) the first date on which no tax-exempt private activity bond (as that phrase is used in Section 142(d)(2) of the Code) issued with respect to the Mortgaged Property is outstanding;</li> <li>(c) the date on which any assistance provided with respect to the Mortgaged Property under Section 8 of the Housing Act terminates.</li> </ul>		
Occupancy Requirements	At least 20 percent of units must be reserved for households with incomes at or below 50 percent of area median income <u>OR</u> 40 percent	At least 20 percent of units must be reserved for households with incomes at or below 50 percent of area median income <u>OR</u> 40 percent		

	of the units must be reserved for households with incomes at or below 60 percent of area median income.	of the units must be reserved for households with incomes at or below 60 percent of area median income. The project may have to satisfy <u>both</u> requirements. See the Regulatory Agreement.		
Rent Requirements	Rents for qualified units must not exceed the applicable rent limit for the LIHTC program.	There is no rent restriction on bond-financed properties. However, if combined with tax credits, the rent must not exceed the tax credit rent limit.		
Income	The rules for determining income-certified tenants are the same for both programs.	The rules for determining income-certified tenants are the same for both programs. See the Regulatory Agreement for specific requirement.		
Reexamination of Income	Re-examinations are performed annually following the same procedures as initial certification.	Re-examinations are performed annually following the same procedures as initial certification.		
Interim Recertifications	The LIHTC program does not require interim recertifications. Changes in household composition or changes in income need to be reported only at the time of recertification. This may change in the future.	Recertifications are required if the number of occupants in a unit changes (other than the birth of a child).		
Over-Income Tenants	Over income tenant is an existing tenant whose income, at recertification, is determined to exceed 140% of the applicable income limit. An increase in a tenant's income does not necessarily disqualify the unit as a low-income unit, provided the next available	Over income tenant is an existing tenant whose income, at recertification, is determined to exceed 140% of the applicable income limit. An increase in a tenant's income does not necessarily disqualify the unit as a low-income unit, provided the next available		

	unit of comparable or smaller size is rented to a qualified low-income household.	unit of comparable or smaller size is rented to a qualified low-income household.		
Next Available Unit Rule	The next available comparable unit rule is applied on a building-by-building basis.	The next available comparable unit in the building must be rented to a qualified household.		
Full Time Student Household	Full time student status must be checked annually. Units occupied by full time students are not allowed unless one of the exceptions applies.	Full time student status must be checked annually. Units occupied by full time students are not allowed unless one of the exceptions applies.		

Owners of qualified tax-exempt bond properties must comply with all regulatory agreements and program regulations. Owners' files must include the following:

- Initial and annual income certifications, income verifications/documents, etc.
- Complete records of unit history/occupancy reports
- Leases (6-month minimum term, as property cannot be used on a transient basis)
- Interim recertifications are required if number of occupants in the unit changes for any reason other than the birth of a baby to an occupant of the unit
- Copy of Certificate of Continuing Program Compliance
- Copy of IRS form 8703

## **XI. HOUSING AND DEVELOPMENT SOFTWARE**

ADFA has implemented the mandatory use of its web-based compliance and monitoring software. Entering data online is utilized in place of the written status reports and is statutorily required by ADFA pursuant to IRC Section 42, subsection 1.42-5 Recordkeeping and record retention provisions. Failure to enter data will be reported to IRS as noncompliance. Online entry applies to all active projects, applicable foreclosed properties, and applicable projects that received a partial release of the terms of the LURA. A separate procedures manual is available. Training sessions will be announced.



Adopted by the Board of Directors of the Arkansas Development Finance Authority this

| \_\_\_\_\_ day of \_\_\_\_\_, ~~2008~~ <sup>2009</sup>

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By: \_\_\_\_\_  
Art Morris, Chairman

ATTEST:

By: \_\_\_\_\_  
Mac Dodson, President/Secretary

## GLOSSARY

**20/50 TEST:** Requirement whereby 20 percent or more of the residential rental units are rent-restricted and occupied by households with incomes of 50 percent or less of the area median gross income, adjusted for family size. This test is referred to as one of the “minimum set-aside” requirements. Compliance with the minimum set-aside requirements must be maintained at all times during the compliance period. Failure to meet the elected test will disqualify a development from being eligible for the credit.

**40/60 TEST:** Requirement whereby 40 percent or more of the residential rental units are rent-restricted and occupied by households with incomes of 60 percent or less of the area median gross income, adjusted for family size. This test is referred to as one of the “minimum set-aside” requirements. Compliance with the minimum set-aside requirements must be maintained at all times during the compliance period. Failure to meet the elected test will disqualify a development from being eligible for the credit.

**30 PERCENT CREDIT:** The 30-percent present value credit applies to acquisitions of existing housing or for new construction/rehabilitations which are federally subsidized. The 30 percent credit will yield, over the 10-year credit period, a tax benefit equal to 30 percent of qualifying costs. On an annual basis, this present value computation approximates a 4-percent figure each year over the credit period to arrive at the 30-percent credit.

**70 PERCENT CREDIT:** The 70-percent present value credit applies to new construction and qualifying rehabilitations. The 70-percent credit will yield, over the 10-year credit period, a tax benefit equal to 70 percent of qualifying costs. On an annual basis, this present value computation approximates a 9-percent figure each year over the credit period to arrive at the 70-percent credit.

**ACCELERATED PORTION OF THE CREDIT:** In exchange for 10 years of tax credits, under the low-income housing credit program, a building owner agrees to comply with IRC Section 42 for at least a 15-year period. This accelerates the tax benefits over a shorter term and lengthens compliance to 15 years. In each of the 10 years of the credit period, the building owner effectively receives an additional 1/3 of the credit which is accelerated from the 11<sup>th</sup> through 15<sup>th</sup> years. Thus, the credit for each year consists of both the “earned” portion (2/3) and the accelerated portion (1/3). It is the accelerated or unearned portion that must be recaptured as a result of decreases in qualified basis or disposition events.

**APPLICABLE FRACTION:** The applicable fraction, which is calculated for each building, is the lesser of (a) the number of LIHTC units divided by the total number of units in the building, or (b) the total rentable square footage of LIHTC units in the building divided by the total rentable square footage in the building.

The Applicable Fraction is established during rent-up. Once established, the Applicable Fraction for a building must never fall below this initial fraction. Failure to maintain applicable fraction could result in recapture of tax credits.

**AREA MEDIAN GROSS INCOME (AMGI):** A term which represents the midpoint (that is, half are above and the other half are below) income level for a given area. Those figures are published annually by HUD based on various population and earnings data. The AMGI figure, adjusted for family size, is used in the determination of whether or not a household qualifies as “low-income” for purposes of the LIHTC program.

**BEDROOM ELECTION:** This election allows owners of low-income buildings with allocations before 1990 or on financed buildings placed in service before 1990 to determine the gross rent limitation for rent-restricted units under the number of bedrooms method. In this method, a set occupancy is assigned based on the number of bedrooms contained in the low-income unit. Previously, the actual number of occupants was used to determine the rent restriction.

**BELOW MARKET LOANS:** A loan funded in whole or in part with federal funds, if the loan is less than the applicable federal rate in effect under IRC section 1271(d)(4). There are six basic categories of below market federal loan programs: (1) federal tax-exempt interest loan, (2) IRC section 236 loans, (3) IRC section 515 loans, (4) IRC section 312 loans, (5) IRC section 221(d)(3) and (4) loans, and (6) flexible subsidy loans.

**BUILDING IDENTIFICATION NUMBER:** This is the nine-digit alpha numeric designation assigned by the state housing credit agency to a low-income building. Essential to the monitoring process for IRC section 42, IRS Notice 88-91 provides information regarding building identification number requirements.

**COMPLIANCE PERIOD:** This is the fifteen (15) year period over which a development must maintain compliance with IRC section 42. This period begins with the first taxable year of the credit period. The compliance period may be extended another 15 years by terms of extended use provisions.

**CREDIT PERIOD:** The 10-year period over which an owner may claim tax credits annually on a building-by-building basis. The tax credit period begins either with (a) the taxable year in which the building is placed in service or (b) the succeeding taxable year (if elected by the owner).

**ELIGIBLE BASIS:** That portion of the development allocated credits and for which credits are allowable. Eligible basis consists of (1) the cost of new construction, (2) the cost of rehabilitation, or (3) the cost of acquisition of existing buildings acquired by purchase (including the cost of rehabilitation, if any, to such buildings incurred before the close of the first taxable year of the credit period

which do not exceed a prescribed minimum amount). Only the adjusted basis of the depreciable property may be included in eligible basis. The cost of land is not included in adjusted basis.

**EMPTY UNIT:** An LIHTC unit that has never been rented.

**EQUITY:** This term refers to the funds provided by investors in a project. The amount of this investment is contingent upon the value attributed to the tax benefits generated by ownership in the project. Equity represents one of the basic financing layers in a project.

**EXTENDED LOW-INCOME HOUSING COMMITMENT:** A binding agreement between the owner and the housing credit agency that obligates the owner and any successors to maintain specific occupancy and affordability requirements for the development.

**GENERAL PUBLIC USE:** The legislative history of IRC section 42 and Treas. Reg. Section 1.42-9 provides that the residential rental units upon which a low-income housing credit is taken must be available for use by the general public. A residential rental unit is for use by the general public if the unit is rented in a manner consistent with housing policy governing nondiscrimination. HUD Handbook 4350.3 is the appropriate reference source.

**GROSS RENT FLOOR:** This ruling allowed the owner to establish floor rent amounts that will not be affected by fluctuations in the income limits and maximum rent ceilings. For developments that received an allocation of credits or determination letter on or after October 6, 1994, the owner may elect to establish the gross rent floor as the maximum rent in effect either on the date the development was placed in service or on the date the development received an allocation. This irrevocable election must be made by the owner and submitted in writing to ADFA no later than the placed-in-service date of the development.

**GROSS RENT LIMITATION:** Gross rent may not exceed 30 percent of the applicable qualifying income as adjusted for household size. Gross rent includes the cost of utilities, except telephone and cable. If utilities are paid directly by the tenant, the maximum rent must be reduced by the amount of the utility allowance. The gross rent limitation applies only to payments made directly by the tenant. Any rental assistance payment (such as HUD Section 8) is not included in the gross rent limitation.

**HOUSEHOLD INCOME LIMITATIONS:** One of the requirements of the minimum set-aside test, household income limitation of a qualifying unit is a set percentage of the area median gross income figure. In accordance with the minimum set-aside elections, the income level may be no greater than 50 percent or 60 percent of the respective area median gross income. A household can

consist of one or more persons. Count all household members and compare to the per person income limits. You may count unborn children or children in the process of being adopted as members of the household for income limit purposes.

**INCOME CERTIFICATION:** All qualifying units must have adequate documentation to support the household income limitation at initial lease-up as well as annually throughout the compliance period.

**LOW INCOME UNIT:** A low-income unit includes any unit in a qualified low-income building if the individuals occupying such unit meet the income limitations and if the unit meets the gross rent restrictions.

**MARKET UNIT:** Any non-LIHTC unit whether occupied or not.

**MINIMUM SET-ASIDE TEST:** This is a requirement that must be met at all times during the development's compliance period. This test restricts rent and dictates which households qualify as low income and how many units must be occupied by the qualifying households. The two general minimum set aside tests are the 20/50 and the 40/60 tests, which are defined in the glossary.

**MOVE-IN CERTIFICATION:** The form, signed by both the resident and owner's representative, summarizes household composition, projected household income and assets.

**NEXT AVAILABLE UNIT RULE:** The rule states that if an existing tenant's income in a LIHTC unit increases above 140 percent of the applicable income limitations (over-income unit), the next available unit of comparable or smaller size must be rented to a low income tenant to continue treating the over-income unit as a low income unit within that building. In fact, all comparable units that subsequently become available in the same building must be rented to qualified residents until the applicable fraction is restored to the percentage on which the credit is based.

**OCCUPIED UNIT:** An LIHTC unit that has been rented.

**OWNER'S CERTIFICATION:** A building owner must provide certification to ADFA every year that the low-income units in a development are occupied by qualifying households. Failure to provide such certification in a timely manner will result in the filing of IRS Form 8823 (Report of Non-Compliance or Building Disposition (Non-compliance Report) by ADFA.

**PLACED IN SERVICE:** "Placed in service" is defined in IRS Notice 88-116, 1988-2 C.B. 449, as being the date on which the first unit in the building is first certified as being suitable for occupancy under state or local law. For rehabilitations which qualify for treatment as a separate new building, the placed

in service date would occur at the end of the 24-month period over which such expenditures are aggregated.

**QUALIFIED BASIS:** The “Qualified Basis” is the formula used to calculate how much tax credit will be provided. Qualified Basis amounts are determined as the proportion of eligible basis in a qualified LIHTC building attributable to the LIHTC rental units. This proportion is the lesser of (1) the proportion of low-income units to all residential rental units, or (2) the proportion of floor space of the low-income units to the floor space of all residential rental units.

**RECERTIFICATION:** The annual re-determination of household income and composition for continuing eligibility.

**RECAPTURE:** Recapture refers to an adjustment in which the accelerated portion of the credit, plus interest, is recovered as a result of reductions in qualified basis (including but not limited to the partial or full disposition of the building or interest therein). If the qualified basis on which credit is taken decreases, recapture applies to that portion of the qualified basis that is no longer eligible for the credit. If a project ceases to meet the minimum set-aside requirement, the project no longer qualifies as a low-income housing project until the minimum set-aside is again met, and recapture is applied to all credits previously taken on the entire project.

**SINGLE ROOM OCCUPANCY (SRO) UNITS:** Residential rental units must generally contain complete living, sleeping, eating, cooking, and sanitation facilities. IRS section 42 provides an exception to this definition which allows SRO units to qualify as residential rental units even if eating, cooking, and sanitation facilities are on a shared basis.

**STUDENT TENANTS:** Units occupied entirely by full time students will not be eligible. Exceptions apply for students who are single parents of children who are also full-time students, provided no one is claimed as a dependent of a third party other than a parent of the dependent children. Married students who are entitled to file a joint tax return are also exceptions, as are students enrolled in certain job training programs or those receiving welfare assistance under Title IV of the Social Security Act.

**UNIT FRACTION:** The percentage of low-income units in a building expressed as a fraction—the numerator of which is the number of low-income units in the building and the denominator of which is the number of residential units (whether occupied or not) in such building.

**UTILITY ALLOWANCE:** A calculated average of expenses for utilities (other than telephone and cable) for units comparable in size or the utility allowances

used by the local Public Housing Authority or Section 8 office. Utility allowances are calculated annually.

**VACANT UNIT:** An LIHTC unit from which someone has moved.